

Revised: November 8, 2007

**MINUTES
of the
SECOND MEETING
of the
TOBACCO SETTLEMENT REVENUE OVERSIGHT COMMITTEE**

**August 27, 2007
University of New Mexico Children's Hospital Conference Room
Albuquerque, New Mexico**

The second meeting of the Tobacco Settlement Revenue Oversight Committee was called to order by Representative Gail Chasey, co-chair, on August 27, 2007 at 9:00 a.m. at the UNM Children's Hospital Conference Room in Albuquerque, New Mexico.

Present

Rep. Gail Chasey, Co-Chair
Rep. Danice Picraux
Sen. John C. Ryan
Rep. Gloria C. Vaughn

Absent

Sen. Mary Jane M. Garcia, Co-Chair
Sen. John T.L. Grubestic

Advisory Members

Sen. Rod Adair
Rep. Ray Begaye
Sen. Joseph J. Carraro
Sen. Dede Feldman
Sen. Linda M. Lopez
Rep. Teresa A. Zanetti

Sen. James G. Taylor

Staff

Roxanne Knight, Legislative Council Service (LCS) Researcher
Jacob Winowich, LCS Intern

Guests

The guest list is in the meeting file.

Copies of all handouts and written testimony are in the meeting file.

Monday, August 27

Representative Chasey welcomed committee members and guests. Carlos Romero, associate vice president in government and community relations at the University of New Mexico (UNM), welcomed the committee members to the UNM Children's Hospital and Cancer Center. Mr. Romero reported that the UNM Children's Hospital has only been open for a couple of months, and he hoped there would be time to tour parts of this new state-of-the-art facility.

Although the president of UNM, David J. Schmidly, was unable to attend the meet-and-greet session, he did take the opportunity to visit with the committee during its afternoon session.

Approval of the June 2007 Minutes

The minutes of the June 22, 2007 meeting were adopted unanimously by the committee members on the motion of Senator Feldman, which was seconded by Representative Vaughn.

Lovelace Respiratory Research Institute (LRRI) Performance Report

Dr. Robert Rubin, president and CEO of LRRI, gave the first presentation, explaining that he represents an independent, private research institute serving humanity through research on the prevention, treatment and cure of respiratory disease. The LRRI is interested in curing the effects of tobacco use. The organization's original expectation for use of state contract funding (from tobacco settlement revenue appropriated to UNM) was to leverage it for research dollars with an eye toward potential economic development. He noted that 450,000 New Mexicans are past and present tobacco product users.

He reviewed the major scientific accomplishments of the organization since 2001, including its most notable accomplishment, establishment of the Lovelace Smokers Cohort, which has now enrolled more than 1,900 smokers, mostly women whose medical histories and genetics are evaluated and studied. The participants receive medical support. The LRRI's Chronic Obstructive Pulmonary Disease (COPD) Program is essential to the lung cancer program of the UNM Cancer Research and Treatment Center and the LRRI's Lung Cancer Biology Program. The objective of the LRRI's study is to determine the genetic basis of emphysema and to develop new therapies. COPD is a disease composed of emphysema and chronic bronchitis, and it is a result of severe damage to lung tissue. It is believed that COPD results from an imbalance of proteins that degrade lung tissue and its inhibitors. The LRRI wants to develop drugs that reverse the genetic chemical imbalance caused by smoking.

Since the first funding of the LRRI's tobacco therapeutic program, the LRRI has used state dollars with the help of \$11 million in direct new funding to New Mexico to develop a complex infrastructure. The LRRI has used the related basic science infrastructure of animal exposure systems to obtain over \$25 million in new funding activity from biotechnology and pharmaceutical industries and the National Institutes of Health (NIH); the latter being the LRRI's largest partner. Data suggest that people who have COPD and are on statin therapy live longer and do better than those not taking statins. The LRRI would also like to identify genes critical for the development of COPD, define lung cancer risk and develop an early diagnostic test.

Senator Carraro requested a tour of the LRRI, and he noted there is concern with duplication of effort among the LRRI (another past recipient of tobacco funds), BioModa, Inc., and UNM. Dr. Rubin stated that he does not believe there are overlaps either in New Mexico or nationally. He indicated he does not know definitively if any of BioModa's work is duplicative. Senator Carraro asked if certain information is shared. Dr. Robert Katz from UNM Hospitals noted that thousand of documents exist about the use of statins, which are used for treatment of cholesterol issues, but not for emphysema. He said there is a statin for cardiovascular disease,

too. Dr. Katz indicated that certain "intellectual property" concerns limit the amount of information he could discuss with the committee members.

Representative Chasey recommended that the LRRI meet with BioModa, Inc., and make the distinction between the two groups. Representative Begaye asked about studies involving uranium mining, since there is a high incidence of emphysema in children exposed to uranium mining. Dr. Rubin said there are some studies, and he noted that there may be cultural or environmental differences among smokers, which impact their illnesses. His goal is to find a therapy to treat the disorders caused by tobacco use.

Tobacco Master Settlement Agreement (MSA) Revenue, Litigation, Legislation and Enforcement Update

David Thompson, an assistant attorney general from the New Mexico Attorney General's Office (AGO), reviewed some of the enforcement and litigation issues involving tobacco settlement revenues, the Cigarette Tax Act and the Tobacco Products Act. He was assisted by his paralegal, Claudia Ravanelli. He reported that \$36 million in revenues has been received to date for 2007, and an aggregate amount of \$320 million has been received since 1999 as a result of the MSA.

Mr. Thompson reported that the AGO and the Taxation and Revenue Department (TRD) staff continue to work together closely to meet the diligent enforcement requirements for the state under the MSA. The tobacco companies have filed litigation in all the participating states, including New Mexico, charging that the states have not diligently enforced the MSA, although both he and Representative Chasey noted that New Mexico passed laws as quickly as the legislature could. The participating manufacturers (PM) had requested that the court order arbitration as defined in the MSA concerning the independent auditor's determination not to apply a nonparticipating manufacturer (NPM) adjustment to the PM's 2006 annual payment. Mr. Thompson noted that the most recent court ruling from the First Judicial District Court on June 29, 2007 included an order for arbitration; however, the decision is on appeal at the New Mexico Court of Appeals and the AGO is working on an appellate brief. Representative Chasey requested a private briefing on the case. Regarding enforcement of tobacco laws in New Mexico, Mr. Thompson reported that approximately over \$1 million worth of lawsuits have been filed against noncompliant manufacturers for the sales reporting periods of 2003 through 2006.

Also, he expressed concern that the distributors of tobacco products are not currently required by statute to stamp and ship into New Mexico only those tobacco products on the AGO directory. TRD and the Department of Public Safety (DPS) need the authority to intercept these unstamped cigarettes, which come in bulk across New Mexico's borders. He suggested that legislation be drafted to amend the definition of "contraband cigarettes" to include cigarettes that are not on the AGO directory. Staff was directed to prepare draft legislation for the committee to review at its next meeting.

Other issues noted were: the likely need to address internet sales of cigarettes and to define "small or little cigars", which are cheaper and not regulated like "cigarettes". These

cigars have become nothing more than cigarettes wrapped in brown paper. There are significant tax advantages to the manufacturer to sell "little cigars" as opposed to "cigarettes", and the AGO is very supportive of Proposed Rule 2006R-276P pending before the Alcohol and Tobacco Tax and Trade Bureau that would allow regulation and a more stringent definition of "little cigars". From 2002 to 2005, sales of little cigars have increased 69% and because these are not included in calculations for MSA payments, there is a strong financial incentive for the manufacturers to turn to this product. The committee members noted that most legislation is restricted during the short 2008 session due to the appropriations requirement; thus, a governor's message would be required for legislation to address these issues.

Senator Carraro expressed concern about the cigarettes sold on reservations and suggested there may be a need for a future joint committee meeting with the Indian Affairs Committee. It was suggested that the attorney general ask the tribes to check whether tobacco companies are in good standing and are reflected on the directory. Senator Carraro and other members expressed concern that the tobacco issues be addressed and that New Mexico continue its due diligence to avoid jeopardizing the revenues received under the MSA. Representative Begaye noted there needs to be dialogue with the tribes — government talking to government regarding tobacco issues.

Representative Begaye inquired about the bar coding on cigarettes. It was stated that the federal government regulates codes and that the attorney general should use the code to determine where the box originated. He suggested that the federal government not issue bar codes for an illegal product, to which Mr. Thompson agreed.

It was noted by Representative Chasey that tribes in other states have entered into agreements with their states to allocate some portion of the cigarette tax to the tribes as part of the regulation of tobacco on reservations. The committee suggested that more research be done on this subject. Also, Rep. Chasey asked that the committee be notified about the date for oral arguments on the case pending in the court of appeals.

Tobacco Settlement Permanent Fund Balances and Investments

Michael Custer, an equity portfolio manager with the State Investment Council (SIC), reviewed a handout containing the latest balances in the Tobacco Settlement Permanent Fund. Fifty percent of the tobacco settlement revenues remain in the fund, while the other 50% are distributed to the Tobacco Settlement Program Fund for annual appropriation by the legislature. Effective in FY07, when 4.7% of the balance in the permanent fund exceeds 50% of the revenue stream, then the annual distribution of 4.7% of the average of the year-end market values of the Tobacco Settlement Permanent Fund for the immediately preceding five calendar years will be made to the tobacco settlement program fund for appropriation. He reported that the current market value is approximately \$95 million and that \$21.19 million had just been paid out. He reviewed the actual allocation of the funds in the state's \$14 billion in total assets and the SIC investment strategy.

In response to Senator Carraro, Mr. Custer clarified that the Tobacco Settlement Permanent Fund is invested in a similar manner to other state permanent funds. Although the permanent and severance tax bond funds have some exposure to real estate investments, the tobacco funds do not.

Representative Zanetti made several inquiries about how the SIC manages the investment of state funds and about the losses incurred by the state due to its investments with the investment banking firm Bear Stearns. She asked Mr. Custer to provide follow-up responses to her questions.

Tobacco Settlement Preliminary Revenue Estimates; Update on Permanent Fund

Laird Graeser, chief economist for the Department of Finance and Administration, offered the latest revenue projections for tobacco revenue after giving a brief update on the MSA. He noted that the attorneys general of 46 states signed the MSA with the four largest tobacco companies in the United States and that, since 1998, over 40 additional tobacco companies have joined the MSA. Under the MSA, payments will be made in perpetuity. The central purpose of the MSA was to reduce smoking, particularly youth smoking, in this country. Since the first state settlement was announced, total U.S. cigarette sales have fallen by more than 22%.

Annual payments are subject to three significant adjustments: inflation, volume and market share decline attributable to participation in the MSA. Inflation adds revenue to the base payment and volume adjustment reduces revenue. New Mexico taxable volumes are decreasing.

- The inflation adjustment is the greater of the CPI or 3% and is compounded annually. In a low inflation environment, settling states benefit from the inflation adjustment since they receive at least 3% even if the actual CPI is less.
- The volume adjustment reduces the revenue by the corresponding change in cigarette sales made by the original (since 1998) participating manufacturers (OPMs) — the year the MSA was signed. This is a cumulative adjustment that is made after the inflation adjustment. The revenue estimate assumes an annual volume adjustment of a **negative 2.5%**.
- The NPMs adjustment can reduce the total payments based on the relative market share loss of the OPMs. This adjustment could be sizeable since it is calculated at three times the market share loss of the OPMs, and payments can be reduced by this adjustment. The burden is on the OPMs to show that their participation in the MSA significantly contributed to the loss and once this condition is met, *the burden is on the states to prove that they have adopted and diligently enforced the state model statute*. The OPMs had never claimed this market share adjustment until 2005. As a result, the 2006 payments were about 13% less, \$4.8 million for New Mexico; however, there is active litigation as noted in Mr. Thompson's testimony above.

Projections: New Mexico's base payments through 2025 — prior to adjustments — are calculated at \$1.367 billion; however, after adjustment, the state is expected to receive \$1.061 billion, an amount of \$306 million less.

For FY08, the recent strategic contribution adjustment (SCA) or base increase "bonus payment" begins, which will continue for 10 years. The New Mexico net bonus payment to the Tobacco Settlement Permanent Fund will be about \$5.6 million for FY08 and \$5.8 million for FY09, after the gross payments are adjusted.

The projected net addition to the corpus of the Tobacco Settlement Permanent Fund in FY09 is \$21.0 million; an identical amount is projected for appropriation in the FY09 budget. This amount includes the projected bonus payment.

Mr. Graeser reported that in FY07, New Mexico spending on tobacco prevention was \$7.7 million. In FY08, \$9.615 million is appropriated for tobacco prevention and control programs.

State of the State on Tobacco Issues

Nathan Bush, New Mexico government relations director of the American Cancer Society, offered a policy review for the committee, including a brief review of cigarette taxes, taxes on noncigarette tobacco products, appropriations recommended and funded by the revenues in the Tobacco Settlement Program Fund and smoke-free workplaces. He told the committee that the primary motivations for taxing tobacco products are to prevent and reduce tobacco use and its harmful effects and to gain state revenue from the sale and use in the state of inherently harmful and deadly products, to at least partially offset the harms and costs caused by their sale and use in the state.

He reviewed cigarette tax revenues and stamping requirements, noting that health advocates prefer that taxes remain "price-based" rather than "weight-based". He said that changing to a weight base would make the best selling cigarettes even more attractive price-wise to buyers. He noted that legislation passed during the last legislative session redefined cigarettes to allow inclusion of "little cigars" to gain more favorable taxes on them. He reviewed how both Massachusetts and Florida had stopped or slowed funding of tobacco control programs, which negatively affected the states' successes in tobacco prevention and reduction. He discussed the consumption of large and small cigars and snuff, emphasizing that smokeless tobacco products are highly addictive.

Cigarette tax revenues have remained fairly steady at \$60 to \$61 million annually from 2004-2006. New Mexico cigarette taxes are seventeenth in the nation.

He pointed out that flavored cigarettes and sampling or free promotional cigarettes are used in the marketing of tobacco. He reviewed some of the current marketing trends and the audiences being targeted.

Policy considerations he offered were:

- increasing needs for smoking cessation and youth prevention and countermarketing;
- new, targeted regulation, particularly in the smokeless tobacco and cigar category;
- cigarette tax enforcement;
- state regulation of tobacco flavoring;
- increasing the appropriations for tobacco use and prevention to the level recommended by the Centers for Disease Control (CDC);
- increasing resources for the enforcement of the MSA; and
- fire-safe cigarette legislation to require manufacturers to make cigarettes that go out if not being smoked for a specified period of time.

Senator Feldman expressed concern about cigar bars, and Mr. Bush stated that by next year, there would be few, if any, that could meet the standards for licensing.

Cynthia Serna, director of New Mexicans Concerned About Tobacco, gave a detailed presentation accompanied by handouts about the Food and Drug Administration (FDA) legislation pending in Congress. FDA regulation would provide a strong framework to support state efforts to reduce and prevent tobacco use by both youth and adults and reduce health care and other costs. The legislation would vest the FDA with jurisdiction to regulate both current and new tobacco products and restrict tobacco product marketing. Senator Feldman requested that staff draft a letter to the New Mexico congressional delegation asking for its support in gaining passage of the legislation. The committee unanimously endorsed sending the letter to the congressional delegation.

Ms. Serna discussed tobacco product marketing and provided numerous statistics about the dollars spent on advertising. In 2005, cigarette companies spent \$13.11 billion on advertising and promotional expenses. The five major U.S. smokeless tobacco manufacturers spent \$250.8 million on smokeless tobacco advertising and promotion in 2005.

In New Mexico, \$48 million a year is spent on tobacco product marketing.

Breast and Cervical Cancer Program

Larry Heyeck, deputy director of the Medical Assistance Division (MAD), Human Services Department (HSD), and Virginia Alcon, staff manager of MAD, discussed their program's history; eligibility and program benefits; related statistics; program goals; and the distribution of Medicaid program costs. This program was implemented in July 2002, and 80%

of its funding is from federal funds. The remaining 20% comes from state funds. In FY07, 12,865 women were served by the program; more than 54% of those served are Hispanic. Women in the program receive full Medicaid coverage through fee-for-service.

Walk to the UNM Cancer and Treatment Center Conference Room Lunch Presentation

Committee and staff members, along with Legislative Finance Committee staff, joined Dr. Cheryl Willman, director and CEO of the UNM Cancer and Treatment Center (CRTC) for lunch and a presentation about the cancer center. Dr. Willman gave a compelling presentation, highlighting the major achievements of the CRTC, which is the official cancer center of New Mexico and one of only 60 premier National Cancer Institute (NCI)-designated cancer centers in the nation.

The CRTC provides the state's only higher education programs in cancer health care professions. The CRTC treats more than 40% of all adults and virtually all of the children in New Mexico affected by cancer. The CRTC, under Dr. Willman's direction, has embarked on an ambitious \$90 million capital construction project, breaking ground on a new world-class cancer treatment and clinical research facility that will introduce many new state-of-the-art cancer diagnosis and treatment capabilities that are not currently available in this state. It is projected to accommodate more than 200,000 patient visits every year. There is still a funding need of \$18.7 million, of which Dr. Willman is hoping for \$12 million in direct (cash) appropriations with the remainder from other funding sources such as general obligation bonds.

After lunch, Dr. Willman gave a short tour of small areas of the current facility, where she emphasized the need to complete this construction project slated for a February 1, 2009 opening.

UNM Health Sciences Center Performance Report

Dr. Paul Roth, executive vice president for health sciences and dean of the UNM School of Medicine, and Dr. Richard S. Larson, M.D., Ph.D., vice president for the UNM Health Sciences Center (HSC) translational research and a professor of pathology, gave the committee an overview of the UNM HSC and its organizational structure. The center received \$5.4 million in FY08 appropriations. Various programs are partially funded from the tobacco settlement revenues. They include genomics, biocomputing, environmental health, the LRRI, the New Mexico Poison and Drug Information Center, pediatric oncology, telemedicine, school of medicine faculty recruitment and retention, specialty education in pediatrics and trauma and the area health education center. Nearly \$40 million has been appropriated to UNM HSC from this revenue stream since FY01. A considerable portion of these funds has been dedicated to clinical research and trials allowing researchers to study the safety and efficacy of new medications for the treatment of chronic disease related to tobacco-sensitive organs, including the heart, lungs, brain and kidneys.

UNM is one of the few institutions (1 of 52 universities) in the country to receive a NIH planning grant to transform the way in which clinical research and training is done, and to integrate clinical, translational and basic science research. This will result in \$50 million in

funding over five years. UNM HSC is working to build a biomedical research corridor in New Mexico. For every dollar put into the genomics program, \$10.00 to \$14.00 is leveraged from the federal government.

During the presentation, there was a break to accommodate President Schmidly, who introduced himself and addressed some of his proposals to improve UNM. The committee members took a few moments to introduce themselves and explain which districts they represent.

The meeting was adjourned at approximately 3:30 p.m., and those wishing to participate were given a tour of various sections of the new Bill and Barbara Richardson Pavilion.